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RUEHBUL/AMEMBASSY KABUL 9183  
RUEHNE/AMEMBASSY NEW DELHI 3819  
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SUBJECT: STATE BANK OF PAKISTAN DISCUSSES INCREASING EQUITY MARKET LIQUIDITY

¶1. (SBU) Summary: State Bank of Pakistan (SBP) officials met with market stakeholders on September 22 to discuss proposed fiscal and monetary measures to provide increased liquidity to equity markets. The Karachi Stock Exchange's KSE-100 Index has been frozen at 9,144 points, its value on August 27, to prevent further deterioration in the index's value. The Karachi Stock Exchange Board of Directors has banned the short selling of stocks and the blank sale of futures contracts until at least November. Stock broker representatives called on regulators to do more, including provide capital gains tax exemptions for banks and extend capital gains tax exemptions for non-bank corporate and institutional investors past 2010. End Summary.

¶2. (SBU) The State Bank of Pakistan (SBP) met with Security and Exchange Commission and Karachi Stock Exchange (KSE) officials on September 22 to discuss proposed fiscal and monetary measures to provide increased liquidity to equity markets. The Karachi Stock Exchange's KSE-100 Index has been frozen at 9,144 points, its value on August 27. The market has fallen below 9,144 points on three occasions, triggering a halt to trading. Trading on individual shares is also suspended if share value drops below the August 27 level. The SBP has consulted with both government officials and private sector representatives to consider a fiscal and monetary package to increase liquidity prior to a future removal of the trading floor on KSE share and indexes.

¶3. (SBU) In an attempt to curb market speculation, the Karachi Stock Exchange Board of Directors announced that, effective September 24, the short selling of stocks and the blank sale of futures contracts will be temporarily prohibited. These prohibitions will remain in effect until November, at which point the Board of Directors will review the policy.

¶4. (SBU) Stock broker representatives Arif Habib, Aquil Karim Dedhi and Jahangir Siddiqi, also in attendance at the September 22 meeting, requested that the SBP relax banking regulations to allow further bank investment in the market. Currently, banks can invest 20 percent of available capital in market equities and ten percent of available capital in futures. Broker representatives reportedly requested capital gains tax exemptions for banks, currently in place until 2010 for non-bank investors. The representatives also requested that the capital gains tax exemption for non-bank corporate and institutional investors be extended past 2010 for those companies that participate in share buyback programs. The representatives also asked that buyback dividends be exempted from taxation and that mutual funds, with the approval of share holders, be allowed to invest up to 50 percent of available capital in the KSE stabilization fund.

15. (SBU) In response to broker recommendations, SBP Governor Akhtar reported that the SBP had already pumped Rs 200 billion (USD 2.56 billion) in additional liquidity into the market this year and will closely monitor market needs in deciding whether to extend additional liquidity to the markets. KSE Deputy Manager Juanid Mirza reported to local media that while these initial recommendations were currently under review, it was likely that the State Bank would eventually approve many, if not all, of the proposals. According to Mirza, declining investor confidence coupled with capital flight would eventually force the SBP's hand, as Pakistan's liquidity crunch looks set to worsen.

PATTERSON